The Corporate Reporting Users' Forum

January 31, 2014

Comment Letter on the IASB Discussion Paper;

"A Review of the Conceptual Framework for Financial Reporting

Corporate Reporting Users' Forum - Japan

Preamble

We, the Corporate Reporting Users' Forum Japan, welcome the IASB's efforts to develop the revised Conceptual Framework. We agree with many of the Board's proposals in the discussion paper, "A Review of the Conceptual Framework for Financial Reporting". We hope the Board to continue its vigorous deliberation towards the exposure draft in the direction that the DP explores.

In the mean time, there are some issues which we would encourage the Board to reconsider. Among others, the following are the main areas where we believe the Board's thorough deliberation is needed.

1. The rigorous definition of net income in the SECTION 2—ELEMENTS OF FINANCIAL STATEMENTS",
2. Full recycling of OCI items to net income in the SECTION 8—PRESENTATION IN THE STATEMENT OF COMPREHENSIVE INCOME—PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME.

In the following sections, we summarize members' comments of CRUF-Japan to each question of the DP.

SECTION 1—INTRODUCTION

Question 1

Objective of the Conceptual Framework

A majority of the CRUF Japan support the DP's view over the objective of the *Conceptual Framework.*

We believe that the primary objective of the conceptual framework to provide the IASB with the principles, or the basis to which the Board should conform when it develops a new standard, or revises an existing IFRS. In developing and revising the *Conceptual Framework,* however, we believe that the Board should respect the users of the financial statements, the primary beneficiary of financial reporting.

Meanwhile, the *Conceptual Framework* may serve various stake holders other than the IASB including users, preparers, auditors and regulators as well as national standard setters when they try to understand and interpret individual IFRSs. It may also help the preparers when they set their accounting policy for the transactions which has no corresponding IFRS. We believe, however, these are just the secondary use of the *Conceptual Framework*.

In other words, the *Conceptual Framework* should be the overarching nexus of "basic concepts" for IFRSs as a whole. IFRSs are not the rule-based but the principle-based standards. Accordingly, there naturally remains the possibility of the different accounting practices depending on the preparers' interpretation, however much guidance is issued. We believe it is essential for the Board to establish the solid foundation of the "basic concepts" to prevent the discretionary interpretations by prepares from undermining "comparability" of the financial statements.

While the majority of CRUF Japan shares the above-mentioned view, there are some members who have an alternative view. They believe that the objective of the *Conceptual Framework* stated in the paragraph 1.26 of the DP is too narrow. They point out that the very fact that "Chapter One" of the most textbooks on IFRSs deal with the *Conceptual Framework* indicates that it is the de-facto code of conduct for all stake holders of IFRSs. They believe that there is no justification to make only the IASB its primary beneficiary, leaving the other stakeholders secondary. They insist that the *Conceptual Framework* should be developed for the use of the wider range of stakeholders other than the IASB.

Departure from the Conceptual Framework

We agree with the DP's preliminary view on the departure from the *Conceptual Framework.*

The *Conceptual Framework* is not the "constitution for the IFRSs", while the conformance to the *Conceptual Framework* by the IASB should ensure the consistency among individual IFRSs. Therefore, we believe the departure from the *Conceptual Framework* should be permitted in the rare occasions, when the conformance to it should rather undermine the overall objective of financial reporting. Having said that, we would expect the IASB should surely achieve the accountability in those cases. If not, it should be very difficult for various stakeholders to understand why the IASB accepted, in certain standards, the paragraphs which seem to contradict the *Conceptual Framework*. We are concerned that such confusion among stakeholders may lead to the loss of confidence not only in the *Conceptual Framework* but also in the IASB and IFRSs per se.

Section 2—Elements of financial statements

Question 2 Definitions of assets and liabilities

We agree with the new definitions of assets and liabilities as well as that of the economic resources. We believe the new definitions proposed by the DP are clearer, more succinct and easier to understand than the current definitions. We believe these new definitions, if employed, would provide the stakeholders with the clearer and consistent basis of understanding, reducing the rooms for various interpretations, by eliminating such concepts as "expectation" as well as "probability", hence the probability threshold.

We are not very sure, however, if the probability should be removed from the recognition criteria at the same time as the elimination of the expectation and the probability from the definition of assets and liabilities. See answers to question 3 and 8 regarding this.

In particular, we see the significant improvement in the following three areas;

1. The proposed definition of an asset, "a present economic resource controlled by the entity as a result of past events" is more definitive and thus more sensible than the current definition, "a resource controlled by the entity as a result of past events".

2. The DP proposes to define an economic resource as "a right, or other source of value, that is capable of producing economic benefits", while they are currently defined as something "from which future economic benefits are expected to flow to the entity". The meaning of "producing" appears to be clearer and thus easier to understand than that of "flow to the entity"

3. In our opinion, the expression, "expected to flow to the entity", in the current definition is not clear enough for stakeholders to understand whether it includes any probability threshold or not. Meanwhile, we believe the new definition should successfully replace the notion of "expected to flow" with the notion of "capable", to avoid any indication of the probability threshold. The notion of "capable", in theory, should allow the recognition of assets and liabilities with any probability of occurrence. We discuss this point in detail in our answer to the Question 3. We appreciate this change as a significant improvement.

Question 3 Role of uncertainty

We agree with the preliminary view of the DP on the role of uncertainty in the recognition of assets and liabilities.

We appreciate the preliminary view for eliminating the existing reference to probability of producing economic benefits or obligations in recognition criteria of assets and liabilities. The preliminary view proposes to remove such expressions in the existing recognition criteria from the *Conceptual Framework* as "expected" and "probable", which may imply no more necessity for specific probability threshold. Instead, the preliminary view suggests using the expression of "capable". The IASB is now supposed to decide when the Board develops or revises specific IFRS, if the recognition criteria of that IFRS should include a specific probability threshold or not. We believe this preliminary view would be helpful when the definitions of an asset and liability or their recognition criteria are applied widely in practice.

Question 4 Elements of financial statements other than the statement of financial position

We urge the Board to deliberate vigorously a more meaningful definition of net income. We are disappointed that the DP does not discuss the elements of the statement of profit or loss and OCI more thoroughly. We hope the issue would be discussed with deeper analysis and more prudent deliberation when the Board issues the exposure draft on the new Conceptual Framework.

For example, we do not understand why the DP does not identify the "comprehensive income" as an element of the statement of net income and other comprehensive income, while comprehensive income is just defined as the difference between the two elements of the statement, i.e. "revenue" minus "expenses". Meanwhile, the DP identifies "equity" as an element of the statement of financial position in addition to "assets" and "liability". If "equity" is identified as an element of the statement of financial position, then it seems that comprehensive income should be identified as an element of the statement of net income and OCI. The DP lacks any convincing argument to explain this asymmetrical treatment of equity and comprehensive income.

The DP also concludes that "revenue" and "gains" are the same in nature and so are "expenses" and "losses", leaving the definition of "ordinary activities", which is necessary to separate gains from revenue and losses from expenses, to the a project to review Standards on financial statement presentation. In our opinion, distinction of these four items provides users with relevant information. It appears to be the self-denial of the standard setter's raison d'être that the Board gives up an effort to define elements which carry relevant information just because of difficulty in defining them.

Despite the fact that the comprehensive income is presented now, the most commonly used metrics for investment decisions are still EPS and PER, the basis of calculation of both is net income.

Given the users' practice, we believe the IASB should not avoid the difficulty and encourage the Board to do its best to define net income. In other words, it appears to end up in vain even if we discuss a certain item should be recognised as net income or as OCI in a particular IFRS without definition of net income.

We believe IASB should place its priority on defining "net income" instead of those items related to the statement of cash flow and the statement of change in equity.

We do not understand why the DP places priority on identifying new elements in the statement of cash flows and in the statement of change in equity, while it does not examine how to identify seemingly more important concept of "profits" as an element of the financial statements.

It may be possible for the Board to define the items suggested in the paragraph 2.52 as newly identified elements of the statement of cash flows and the statement of change in equity. However, these statements can be derived without identifying and defining new elements, in such a way as they are derived from the current set of definitions of elements of financial statements. We are rather concerned if we might have unintended inconsistency with the definitions of existing elements of financial statements such as assets, liabilities, revenue and expenses, by defining these items as newly identified elements.

It appears that the Board would implicitly propose, or encourage, the migration from the indirect method to the direct method by defining cash receipts and cash payments as newly identified elements of the cash flow statement. Direct method seems to gain a strong foothold if these new elements are identified and defined.

We do not reject such a proposal per se, even if it is the case. It may not be difficult for the Board to define "cash receipts" and "cash payments" as independent concepts from the existing elements.

That said, we believe thorough deliberation on the benefit of users and the cost of preparers should be a prerequisite for such a migration. We believe most users derive sufficiently relevant information even now from the statement of cash flows based on the indirect method by applying well-established approach. Meanwhile, it appears almost clear that quite substantial costs should be incurred on preparers. We are concerned that the DP fails to present sufficiently thorough analysis for stakeholders to tell if it is appropriate to identify "cash receipts" and "cash payment" as new elements in comments to the Question 4.

Section 3 —Additional guidance to support the asset and liability definitions

Question 5

We agree with the preliminary view of the DP. It appears very difficult to define constructive obligations, while most of us believe it to be a liability. We support the IASB's tentative approach to retain existing definition as a better, if not the best, and practical one. We believe additional guidance under the current definition should foster accumulation of practical experience, which would help stakeholders to establish a clearer consensus about the appropriate boundary between constructive and legal obligations than now.

We agree with maintaining the existing definition of a liability which encompasses both legal and constructive obligations. We do not think it is appropriate to narrow the definition of a liability to include only obligations that are enforceable by legal or equivalent means. We believe a liability should include a constructive obligation that is to be commonly accepted as an obligation. Laws and rules cannot regulate every single economic activity in reality. Thus we are concerned that users of financial information might not be able to obtain decision-useful information, should the definition of a liability be limited to legal obligations.

Question 6

We support View 2 while we do not agree with Views 1 and 3.

View 1 is likely to understate the liability. To the contrary, View 3 is likely to overstate the liability. In either case, we are concerned that such misstatement would have a negative impact on the credit analysis, i.e. the analysis on the probability of default.

CRUF-J's comment letter on the revised Lease ED was based upon View 2. The 2010 ED was based upon View 3, and required a lessee to recognise lease liability based upon its future action. For example, the 2010 ED proposed to recognise the lease liability assuming execution of renewal option in the future or all variable lease payment adjusted to sales. We were concerned that the recognition of the liability which is not the present obligation should lead to overstatement of liabilities. We find that the Board has adopted View 2 instead of View 3 in the 2013 ED currently exposed to the public comments. The 2013 ED requires to recognise those leases with renewal option as liability, only when such option is almost certain to be executed.

Likewise, a lessee is required to recognise those variable lease payments which have become effectively fixed as liability, according to the requirement of the 2013 ED. We believe such accounting treatments proposed by the 2013 ED faithfully represent economic substance of lease contracts and are consistent with our view.

Section 4 — Recognition and derecognition

Question 8 Recognition

We agree with the IASB's preliminary view, which states that an entity should recognise all its assets and liabilities. This principle is, in our opinion, the prerequisite essential to maintain the reliability of the balance sheet.

We also agree with the exceptions of the principle above in the individual IFRSs that are newly developed or revised. We believe intangible assets should not always be recognised automatically just because those assets exist. For example, we do not believe it would provide users with useful information to recognise such intangible assets as development cost or self-developed goodwill as well as negative goodwill. If all self-developed goodwill is recognised, in theory, the price to book multiple must be always 1.0 X. It provides neither relevant information nor faithful representation of intangible assets, if the value of such assets is automatically adjusted to the share price fluctuations so that the price to book multiple may maintain to be 1.0.

Question 9 Derecognition

We agree with the preliminary view. We appreciate the DP's proposal to add the criteria of derecognition to the Conceptual Framework, which the existing version does not have. The preliminary view suggests that an entity should derecognise an asset or a liability when it no longer meets the recognition criteria in principle. Various approaches to portray the changes due to the transaction are accepted on a standard-by-standard basis.

Possible approaches would include (a) enhanced disclosure, (b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk, or (c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

We believe various approaches to depict derecognition should be allowed in order to faithfully represent the transactions, given the fact that the assets are transferred in various ways in practice. We appreciate the DP's preliminary view as such.

Section 5 — Definition of equity and distinction between liability and equity elements

Question 10

Definition of equity

Our views on the definition of equity are split.

Those who support the IASB's preliminary view to maintain the existing definition of equity are concerned that the introduction of mezzanine layer between equity and liabilities would just confuse users because it should make the balance sheet analysis more complicated. They believe such mezzanine layer does not provide users with any relevant information.

Meanwhile, some other members believe each category of equity provides financially important and relevant information and that the IASB should more vigorously deliberate the definition of equity than now.

Remeasurements of equity claims

Meanwhile, we have no strong objection against updating the measure of each class of equity claim. Value of such claim should depend on the difference between the strike price and the share price as well as the time to the expiration date of the option. The preliminary view suggests recognising updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim. We support such accounting treatment suggested by the DP, because it is appropriate and should be required, unless the outstanding of equity claim is not material.

We believe any change due to the remeasurements would be better reflected if recognized in the statement of changes in equity rather than the statement of comprehensive income. We do not believe any change in equity due to the change in fair value should be reflected in retained earnings but in AOCI.

In this regard, we would like to reiterate importance of establishing categories of equity. We are not convinced by the IASB's position stated in the paragraph 5.5, which says that "IFRS does not generally prescribe which categories of equity an entity should present separately, because determining which categories are most relevant to users of financial statements may depend on local legislation and on the reporting entity's governing constitution". We do not see any problem to breaking down equity excluding minority interest and options into general sub-categories such as "paid-in capital", "retained earnings or surplus" and "accumulated other comprehensive income or AOCI". Reserves and allowances required by each jurisdiction may be established separately among the sub-categories.

We also reiterate the vital importance of clear distinction between retained earnings and AOCI in order to determine relationship between net income and recycling in the current Conceptual Framework project. We eager to see the IASB's more vigorous deliberation on this matter in the course of publishing the exposure draft of the revised Conceptual Framework in near future.

Section 6 — Measurement

Question 11

We agree with the IASB preliminary view from the reasons below;

In case of general business corporations, i.e. non-financial companies, we believe the different valuation techniques should be naturally applied to the business assets and to the financial assets, because the objective of holding appears to vary according to the type of asset.

In this regard, we support the DP's approach to classify net income and OCI with respect to the measurement of assets. We believe the change in fair value of financial assets should not be recognized as profits or losses but the OCI during the holding period, and it is appropriate for gains or losses to be recognized as profits or losses through recycling when they are sold.

We appreciate the preliminary view that the selection of a measurement for a particular asset should depend on how the asset contributes to future cash flows and the one for a particular liability should depend on how the entity will settle or fulfil that liability.

We believe the Board should not allow the arbitrary selection of a measurement. Instead, it should require a reporting entity to choose the measurement to reflect the economic substance. We are concerned that the comparability among the different entities, which is important to users, would be considerably damaged if the preparers can choose arbitrarily their measurement from the several alternatives.

We also appreciate the preliminary view that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost. Given the principle of materiality, we understand this view means that the simpler measurement would be acceptable where it is appropriate. Rigorous measurement of items with low materiality does not appear to provide any significant benefit to users despite the heavy costs incurred by preparers.

The followings are our additional comments for specific issues.

(a) We agree with the objective of measurement. Users of financial statements analyze an entity's financial strength, profitability, capital efficiency and performance, using primary financial statements, independently or in combination, such as the statement of financial positions and the statement of net income and OCI as well as notes. Therefore, the each line item presented on the primary financial statements should be useful to users' decision making, i.e. relevant, the measured amount must faithfully represent the economic substance of the reporting entity or the transactions depicted.

(b) While we basically agree with the statement (b), the following expression appears to be more appropriate; "a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements in most cases. That said, there may be certain occasions when a single measurement basis would provide the most relevant information for users."

(c) We agree with the statement (c). We believe in some cases the different measurement basis should be applied to the statements of financial positions and the statement of comprehensive income to provide users with the most relevant information. For example, under a certain business model, the FVOCI category would provide the most relevant information to measure financial assets.

(e) We disagree with the statement (e). We do not think the smallest number of the measurement per se should be a goal as we believe the new standard should naturally have an optimal set of measurements if it is developed successfully enough to be relevant.

Question 12

We generally agree with the IASB's preliminary view. We understand and agree with the Board's preliminary view to classify the assets, particularly financial assets, into the category measured at the current exit price and the one measured at the amortized cost, according to the valuation approaches by objective of holding. When users calculate and evaluate the return on investment, we believe that the similar approach would be applicable regarding the classification of the business assets and the others and the measurement basis for each type of asset.

Regarding the classification and measurement, we have an additional comment on the re-exposure draft on leases published in May, 2013 Depreciation charge is supposed to increase gradually to leave the lease expense constant, under the lessee accounting proposed for type B assets in the current ED. Meanwhile, the lesser accounting for type A assets requires to recognize the unwound gain on the remaining assets, pushing up its book value. We believe the Board needs to deliberate further on the subsequent measurement based on the cost-basis in the examples above.

Question 13

We generally agree with the Board's preliminary view and the proposed guidance in these paragraphs. We would say, however preparers should be required to disclose the supplementary information in the note about liabilities which have a market price, because such information are often quite useful when we assess the credit risk of a reporting entity.

Question 14

We agree with the DP's preliminary view,

We agree with the DP's argument that cost-based information about some financial assets that are held for collection or some financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows.

We also support the DP's view that cost-based measurement techniques may not work to measure value of assets and liabilities with significant variability in contractual cash flows, or the asset and the liability that are highly leveraged.

Question 15

Our members have some further comments on the discussion of measurement in this section as discussed below;

- When certain liabilities are held closely tied with corresponding assets, the subsequent measurement should be based upon the same measurement approach. For example, when the financial assets are held to maturity and thus measured at amortized cost, the corresponding financial liability should be measured on the same measurement basis.

- Some of our members believe the valuation gains should not be recognized when the fair value of the liabilities declines due to the deterioration of the own credit risk. They believe that the valuation gains on liabilities should not be recognized even as the OCI. When the own credit deteriorates, valuation gains on the liabilities must be accompanied by the negative intangible assets, or the decline in the own creditworthiness. Value of intangible assets is mostly maintained by the presumption of going concern. When the going concern presumption is challenged, most of intangible assets should lose their value. If the valuation gains on liabilities are recognized due to the deterioration of own credit, they point out that the intangible assets should be revalued based-upon the somewhat laxer going concern presumption.

- Having said that, they believe that there should be no problem for an entity to recognize gains on buy-back of its debt at the price below the face value. This entity, in their opinion, should have proved that their credit standing has not deteriorated, by demonstrating its financial strength with the fact that they can buy back its debt.

- They appreciate that the Board does not allow to include the impacts of worsening own credit on the measurement of liabilities for the post retirement obligations and insurance liabilities.

Section 7 — Presentation and Disclosure

Question 16

We generally agree with the DP's preliminary view. Having said that, we believe it is not enough to make the notes to be sufficiently informative. We hope the Board to deliberate further on the distinction between the items which should be presented on the financial statements and those which should be disclosed on the notes to develop the clear guidance to classify them.

Some stakeholders point out that the IFRSs under development tend to require far more voluminous and complex disclosure than the current requirements of the existing IFRSs or the national GAAPs. Given this trend, we believe the materiality should become more important than ever in view of the cost and benefit of disclosure.

Given the objective of the general purpose financial reporting, we believe it is essential for the conceptual framework to deal with the "presentation and disclosure". We have no objection against the preliminary views on the financial statements and their objectives. In particular as a user of financial statements, we agree with the paragraph 7.19, which sets out the complementary relationship between the presentation on primary financial statements and disclosure on the notes.

If we add something, we believe the reporting entity's business model should be clearly explained in the disclosure on the notes. In addition, the conceptual framework should include the guidance to foster communication. We believe these are effective for investors to better understand the reporting entity's medium to long term business potential.

Question 17

Majority of our members agrees to the Board's proposal that IASB does not amend, or add to, the guidance in the conceptual framework on materiality. We believe that the concept of the materiality itself is well understood by the various stakeholders. What we need appears to be the more case-specific guidance. We support the Board's proposal to develop additional guidance or education material on materiality outside the Conceptual Framework project. We hope that the examples and guidance are appropriate and clear enough not to lead to the different practice.

Some members, however, have somewhat different view. They believe the Board should consider amending the QC11 of the current Conceptual Framework, which says that the Board cannot specify a uniform quantitative threshold for materiality. They think lack of the quantitative threshold for, or clear definition of materiality makes it difficult for users, preparers and other stakeholders to reach consensus whenever they discuss on the EDs of the new standards or other materials.

Question 18

Most of our members agree with the preliminary views of the DP.

The information relevant to users is likely to be not only important but also useful to the management. Preparers, however, quite often strongly resist the onerous disclosure requirement, such as the reconciliation tables for contractual assets proposed by the revenue recognition ED, which users around the world support enthusiastically. We believe preparers should accept the required disclosure in principle, no matter how high the cost is to update their financial reporting process and systems. In such a case, however, it is technically very difficult to compare the benefit to users and the cost to the preparers.

The preparers may be able to provide users with alternative non-GAAP information without the auditor's assurance with reasonable cost, in the form as relevant as the one required to disclose on the notes by the individual IFRSs. Non-GAAP information is generally out of the scope of the individual IFRSs. We think, however, it is appropriate for the IASB to deliberate and present its thought on the possibility to replace the disclosure on the notes with non-GAAP information in the communication principle in the Conceptual Framework or in the guidance on materiality. At the same time, it is necessary for the Board to reiterate that it is preparers' responsibility to provide users with decision useful and relevant information, given the objective of general purpose financial reporting.

Meanwhile, some of us strongly disagree with the DP's preliminary view. They insist that it is not the objective of the financial reporting for the preparers to provide the information that they want to present, but to provide users with the relevant information. It may be sometimes costly for preparers to provide such information to users or they may simply be hesitant about disclosing information in detail. Thus, they are concerned that the quality of financial reporting may deteriorate if the Board put too much emphasis on the preparers' cost.

In addition, there are diverse interests among various users. They are afraid that the comparability of financial statements among entities may substantially be damaged, should preparers' discretion lead to the substantial variation in the order of presentation and disclosure.

They argue that it is not fair to criticize the huge volume of financial statements as a whole under the current GAAP because financial statements are the set of information which are judged to be necessary to represent faithfully each item of assets and liabilities. They believe the disclosure requirements should never be eased just because some other national GAAPs require less.

Section 8 — Presentation in the Statement of Comprehensive Income – Profit or Loss and Other Comprehensive Income

We propose the full recycling of OCI through question 19-21.

We agree the principle that the change in the fair value of assets should be recognised in the OCI and in the net income when the certain trigger such as sale of the assets meet the definition of the net income. However, we are concerned that the approaches 2A and 2B proposed by the DP is too narrow. We believe it is useful for our decision making to distinguish realized gains or losses upon sale of the assets from those unrealized amount. These changes on the profit loss and the OCI statement are perfectly consistent with the incremental changes in the retained earnings and the ACOI account on the statement of the financial position. We believe the only full recycling should provide the full picture of these correlations between the P&L and the OCI statement and the statement of the financial position, which allow the users to better understand the whole picture of the financial performance and financial position of an entity. In this regard, we are strongly concerned that partial recycling under the current IFRSs as well as proposal in the DP would rather damage this perfect linkage between the two statements.

One of our members believes the presentation of subtotal income such as business profits should also be mandated. He does not deny the vital importance of the net income and the comprehensive income, as the profits available for the common share holders after interest and tax payments.

These incomes should represent the incremental increase in share holder value as a result of the operation for the year and change in the business circumstances during that year.

He believes, however, that these incomes are not useful enough to estimate the future financial performance of an entity, pointing out that many investors view the operating or business profits as the most important measure of the financial performance instead of the net income and the comprehensive income, according to the analysis of questionnaires to the professional investors.

Net income may include the realization of the past price changes, which has nothing to do with the management's efforts during the reporting period. Likewise, comprehensive income may include the unrealized price changes related to the market movements, which is also beyond the control of the management. Investors' mean estimate of the price changes due to the market movements should be zero. Accordingly, most investors should make their earnings forecasts based upon the business profits basis.

Hence, he believes that the subtotal income, which might be tentatively called as "business income", should be presented as a separate line item on the P&L and the OCI statement, in order to provide investors with relevant, or decision useful information. In order to make the contribution to the incremental increase in the common share holders' equity more visible, he proposes to present the business profits after interest expenses and taxes. In short, there should be three subtotals and one total income, "net business income", "net non-business income", "net income" which is the sum of net business and non-business incomes, and "comprehensive income" on the statement of the P&L and the OCI.

This member explains the current situation in Japan as follows;

Gains and losses on the sale of securities still account for the significant portion of total corporate profits in Japan, which he would say is hardly the margin of error. He believes such manipulation of profits might no more be rampant in Japan, but still regrets to have seen the monstrous and tremendous amount of gains on the sale of shares just to manipulate net income in the past after the burst of the bubble. He believes the P&L and the OCI statement will be far from relevant, at least for Japanese companies, if it continues to include only the incomes with these noisy gains and losses.

He proposes to present the net business and non business incomes as separate line items on the statement of comprehensive income, instead of being disclosed on the notes, in order to avoid financial statements from confusing retail investors who have very limited ability of financial statement analysis or even the institutional investors whose approach is quantitative and just process data of enormous number of different companies. If the net business and non-business incomes are presented in separate line items, it should no longer be necessary to distinguish gains on sale of shares from those on sale of bonds.

He believes that this approach to distinguish the net business and non-business incomes as separate line items should satisfy two conflicting objectives, to meet the needs of investors and analysts who believe the full recycling provide the useful information and to discourage the manipulation of net income through gains on sale of financial instruments (see the paragraph 8.25 (b) and (e)).

He also insists that "business assets" should be defined to exclude the cross-share holdings or strategic share investments. If the definition of business assets would have the room to include these, he suggests the recycling of the gains on sale of stocks should never be permitted to prevent manipulation of the net income.

Question 19

We agree the DP's preliminary view.

Net income and EPS provide the users of the financial statements with the basis for the most commonly used valuation such as P/E ratio. We know such valuation is just one-sided and not perfect. That said, it provides the users with sufficiently comparable and verifiable inputs in the most cost-effective way, when users entering into the preliminary process of decision making by comparing the valuation of a company over time or those among peer companies.

Some insist that net income is an insufficient and misleading indicator, but such criticism just neglect the reason why the net income, EPS as well as P/E multiple have been used in practice for so many years by the overwhelming majority of professional users. It is true that many investors, including ourselves, uses non-GAAP information as well, but that does not automatically deny the relevance and the significance of the net income as summary information.

Question 20

We would propose the full recycling, or the recycling of all OCI items shown in the broad approach, or the approach 2B, instead of the two alternatives, the 2A and 2B, which the DP explored as the possible approaches of the recycling of the OCI items.

Our view is illustrated below;

The sum of the net income and the OCI, i.e. the comprehensive income, explains the change in equity excluding the capital transaction. Then the change in equity is divided into the change in retained earnings or the surplus caused by the net income and the change in the accumulated OCI (AOCI) caused by the change in fair values. The two are the same in the sense that they are economic returns. However, we believe the retained earnings are qualitatively different from the AOCI, because the former would not be affected by the subsequent change in the fair value while the latter would. We believe the distinction between the two is relevant. The management cannot control the change in the AOCI as they cannot control the market moves. The distinction of the change in retained earnings and AOCI thus provides users with the relevant information regarding the change in exposure to the market risk.

The management can reduce the risk on the balance sheet by selling the fair-valued assets and so on. This transaction would cause the transfer of the corresponding AOCI to the retained earnings. If there is no recycling in some cases, these changes on the statement of the financial positions should lose linkage with the statement of the net income and the OCI. We are concerned that this non-recycling would result in the loss of the relevant information on the statement of net income and the OCI that the management reduced how much exposure to the market risks intentionally, fixing the surplus as the retained earnings. We believe such information as above on the risk control by the management should provide the performance related information in a broad sense.

We can assess the economic return properly only when we know how much risk an entity takes to earn that return and how those risks are managed by the management. The relevance of information is the same if the class of the assets sold is the debt instruments classified as FVOCI or the equity instruments. We are concerned that the asymmetric treatment of the two does not represent the economic substance faithfully.

Another member points out that the realized amount is the fixed amount backed by the cash and its hardness is higher than that of the volatile estimates measured by the fair value. He believes that the information with high hardness is worth recognition in the statement of the comprehensive income.

He is concerned that the distinction between the AOCI and the retained earnings will become blurred if all the OCI items are not recycled. He points out that retained earnings represents the amount which has already determined to be attributable to the shareholders, while the AOCI just represents the estimate of accumulated unrealized gains or losses at the reporting date, which is still uncertain. He believes the clear-cut distinction between the two is relevant and the full-recycling should be the prerequisite for such distinction. The IASB appears to be reluctant to discuss the classification within the shareholders' equity because the Board believes it is different among jurisdictions.

While he agrees with the Board's view as far as the distinction between the reserves and the allowances is concerned, he still insists that the Board should define the paid-in capital, the retained earnings and the AOCI.

The full recycling allows the users to use the two distinctive profits, the net income, the fixed amount backed by the cash and the comprehensive income, which includes estimates. He admits that the net income would also include some estimates such as those of the investment securities and the impairment losses on the inventories to calculate the profit or loss attributable to the reporting period. That said, he believes that there is the fundamental difference between the estimates to calculate the profit/ loss for the year and estimates to gauge the financial health of the balance sheet.

Some argue that the recycling enables the management to manipulate the profits. However, he believes the managements' incentive for such manipulation should have been substantially curbed, because the amount of the recycling has already presented in the statement of the comprehensive income. Careful users can recognise the management intention to manipulate the net income quite easily, and such information obtained through thorough financial statement analysis per se is relevant.

Some argue that the recycling makes it more difficult to recognise the sustainable income. However, we believe users generally recognise the operating income and EBITDA as the sustainable income of an entity. In other words, users generally look at three different line incomes, namely the sustainable income such as operating income or EBITDA which is not affected by the entities' capital structure, the net income as the definite performance and the comprehensive income which includes estimated profits and losses. The users can easily identify the amount of recycling and thus calculate the sustainable income without any trouble.

Question 21

We believe that there should be an alternative approach to that proposed by the DP's preliminary view, the one which require the recycling of all OCI items specified in the approach 2B. We believe the requirement to recycle all OCI items should provide the most relevant information from the reasons we mentioned in the answer to the question 20.

We believe the OCI should include the unrealized changes in enterprise value as broadly as possible, in order to better recognise the change in an entity's value. However, the unrealized revenue and expenses recognised in OCI should be recycled in the net income when they are realized.

While most of us prefer the approach 2B to 2A, we disagree with the paragraph 8.91, which says, "transitory remeasurements are recycled only if the recycling adjustment provides sufficiently relevant information to justify the cost and complexity that recycling adds to financial reporting." We believe all OCI specified in 2B should be recycled instead.

Beside our consensus view above, some of our member question the DP's classification of the three approaches 1, 2A and 2B from a different point of view;

The OCI is the bridging item of B/S and P/L per se. They believe the mismatch and temporary re-measurement are the causes of such bridging and the bridging item and the other two are fundamentally at the different levels. They think the issues on recycling become unnecessarily complicated by the absence of the definition of the net income.

They believe the unrecognised liability of the retirement benefits should be recognised as an expense as soon as they are accrued, because such liability is just the difference in estimated expense for the retirement benefits. The current non-recycling treatment of the unrealized obligation allows the management to boost the net income intentionally by reducing the expenses on retirement benefits. They insist such a loophole must be closed immediately.

Section 9 — Other Issues

Question 22

We believe the concept of "prudence" is one of the most important attribute for the relevant financial statement, and would like to ask the Board to deliberate if it should be included again in the Conceptual Framework. The overly optimistic financial statements appear to be more harmful than the overly prudent ones. We believe any accounting standards implicitly or explicitly based upon the principle of prudence, as indicated by the fact that the treatment of recognition of allowance and contingent liabilities are different from that of contingent claims.

Question 23

We support the use of the business model when the Board develops or revises particular standards. We do not see any problem with the business model concept which is already used in existing IFRSs for financial instruments and segment.

Question 25

We believe it is essential for the financial statements to be normally prepared on the going concern assumption. We also believe the statement in the paragraph 9.42 of the DP is fair enough.

We would like to add the following case to the situation where the going concern assumption might be relevant. Suppose that an entity recognizes the valuation gains on the revaluation of the liability due to a reporting entity's worsening own credit risk. Such recognition of valuation gains on the liability appears to mean the relaxation of the going concern assumption. If this is the case, we believe the intangible assets must be revalued correspondingly based upon the less rigorous going concern assumption. We are concerned that it should not be consistent and likely to mislead the users to recognize the valuation gains just on the liabilities side by relaxing the going concern assumption. We believe valuation gains of the liabilities due to the worsening own credit are likely to be completely, or more than, offset by the revaluation losses on the intangible assets in such a case.

Question 26

We agree with the IASB's plan of the treatment of the capital maintenance except the revaluation model of fixed assets. We believe the Board should redeliberate this model in light of measurement and recycling.

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